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414031—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 565

JAMES C. JONES, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 11–13) is unreported. The opinion of the Circuit Court of Appeals for the Eighth Circuit (R. 24–29) is reported in 120 F. (2d) 828.

JURISDICTION

The decree of the Circuit Court of Appeals was entered on June 24, 1941 (R. 29), and the order denying a petition for rehearing was entered on

July 23, 1941 (R. 41). The petition for a writ of certiorari was filed with this Court on August 29, 1941. Jurisdiction is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

When a taxpayer, who owns premises subject to a mortgage which he did not assume, permits the property to be foreclosed because the value of the property has fallen below the amount of the mortgage, is the loss a capital one subject to the limitations of Section 117 (d) of the Revenue Act of 1934, or is it an ordinary loss allowable in full under Section 23 (e) of the Revenue Act of 1934?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or
>
> (3) of property not connected with the trade or business, if the loss arises from

fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(d) *Limitation on Capital Losses.*— Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

* * * * *

(U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (e)–1. *Losses by individuals.*— * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. See section 113 (b).

STATEMENT

The facts were stipulated (R. 9–11) and found by the Board of Tax Appeals as stipulated (R. 12–13). They may be summarized as follows:

In 1931 the taxpayer purchased certain real estate in St. Louis, Missouri, for $35,400. At the time of the purchase there was a deed of trust on the property in the amount of $15,000, and the balance of the purchase price of $20,400 was paid by the taxpayer. The deed of trust was neither executed nor assumed by the taxpayer, although the property was purchased subject to the deed of trust. During the taxable years 1931 through 1934, taxpayer took depreciation on the property at the rate of $500 per year. (R. 12.)

When the taxpayer purchased the property it was being rented for $160 per month. Shortly thereafter property values in the neighborhood deteriorated and the tenant refused to continue to pay $160 per month. In August 1931 taxpayer leased the property for two years at $135 per month. This amount of rent was collected until February 1933 and was thereafter reduced to $115 per month, which amount was collected until the end of the lease, in September 1933. After the lease terminated the taxpayer was never able to secure another tenant and the property became vacant. (R. 12.)

The note for $15,000 which was secured by the deed of trust on the property became due on Janu-

ary 27, 1935. At that time business conditions had so completely changed in the locality that the taxpayer's equity in the property was of no value. Taxes for the year 1934, amounting to $380.04, were past due and unpaid. The taxpayer determined to abandon the property and permit the holder of the deed of trust to foreclose. (R. 12.)

Foreclosure took place on March 16, 1935, and the property was purchased for the sum of $10,000. The property was not purchased directly or indirectly by the taxpayer, nor was it purchased by the holder of the mortgage. No redemption proceedings were instituted by the taxpayer. By reason of the foreclosure sale the taxpayer's equity was completely wiped out. (R. 12–13.)

In his income tax return for the year 1935 the taxpayer claimed the full loss of $20,400, less $2,000 depreciation. The Commissioner limited the loss to $2,000 pursuant to Section 117 of the Revenue Act of 1934, and determined a deficiency in the amount of $1,589.83 (R. 13). The Board of Tax Appeals overruled the Commissioner's determination (R. 13), but the court below reversed and remanded the case with directions to redetermine the deficiency in the amount of the Commissioner's determination (R. 29).

ARGUMENT

In *Helvering* v. *Hammel,* 311 U. S. 504, and *Electro-Chemical Co.* v. *Commissioner,* 311 U. S. 513, this Court decided that losses arising from

foreclosure sales are capital losses. In the court below, petitioner sought to avoid the application of those cases by urging that he had abandoned the property prior to the foreclosure. The Circuit Court of Appeals held that at best there had been a mere purpose to abandon the property which was ineffective without some affirmative act indicating repudiation of ownership.

In this Court, petitioner seeks to avoid the application of the *Hammel* and *Electro-Chemical* cases by contending, not that there was an abandonment, but that the loss did not result from the foreclosure sale because the property had become worthless prior to the foreclosure proceedings. This contention disregards the rule that losses must be established by identifiable events occurring during the taxable year. It also ignores the conclusion in the *Hammel* opinion that in the practical application of the Revenue Acts the sale is the means adopted for determining the amount of the capital gain or loss.

Insofar as *Commissioner* v. *Freihofer,* 102 F. (2d) 787 (C. C. A. 3), lends support to petitioner's position, it must be regarded as out of harmony with, if not overruled by, the *Hammel* decision and by *Helvering* v. *Nebraska Bridge Supply & Lumber Co.,* 312 U. S. 666, reversing *per curiam* 115 F. (2d) 288.

The reference in *Commissioner* v. *Coggan,* 119 F. (2d) 504 (C. C. A. 1), now pending on petition

for writ of certiorari, No. 317, present Term, to a deduction for worthlessness prior to a sale is of no aid to petitioner. The passage quoted by petitioner (Pet. 8) refers to a deduction for worthless stock, which is governed by very different considerations than are applicable in the case of real estate. Moreover, the distinction there made between worthless stock and a worthless equity in stock which still retains some value is equally applicable here, since the property itself had not become worthless.

There is no conflict with *Commissioner* v. *Hoffman,* 117 F. (2d) 987 (C. C. A. 2). While that case allowed a loss upon the abandonment of real estate, petitioner's claim of abandonment was adequately disposed of by the court below and is not relied on here. Petitioner now claims a loss on the ground that the property became worthless prior to the foreclosure sale, not on the ground that he had abandoned it prior to that time.

Schmidlapp v. *Commissioner,* 96 F. (2d) 680 (C. C. A. 2), allowed a deduction, as an ordinary loss, of the value of stock which had become worthless, despite a later public auction of the shares. But it is doubtful whether the same rule is applicable to real estate (cf. *Wieboldt* v. *Commissioner,* 113 F. (2d) 384 (C. C. A. 7)), particularly where, as here, the real estate, as distinguished from the taxpayer's equity, had not become worthless. And if the *Schmidlapp* decision were held appli-

cable to the situation here presented, it would, like the *Freihofer* case, have to be regarded as out of harmony with, if not overruled by, the *Hammel* and *Nebraska Bridge Supply* cases, *supra*.

CONCLUSION

The holding of the Circuit Court of Appeals in this case is correct and involves no conflict of decisions. It presents no problem requiring the consideration of this Court. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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